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No. 93-541

IN THE
# Supreme Court of the United States
OCTOBER TERM, 1993

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NCR CORPORATION,
*Petitioner,*
v.
TAXATION AND REVENUE DEPARTMENT
OF THE STATE OF NEW MEXICO,
*Respondent.*

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**On Petition for a Writ of Certiorari to the Court of Appeals of New Mexico**

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## PETITIONER'S REPLY BRIEF

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JAMES P. KRATOCHVILL
AMERICAN TELEPHONE & TELEGRAPH COMPANY
295 North Maple Avenue
Basking Ridge, NJ 07920

WILLIAM R. CARAPEZZI, JR.
NCR CORPORATION
1700 South Patterson Blvd.
Dayton, OH 45479

WALTER HELLERSTEIN
*Counsel of Record*
PAUL H. FRANKEL
PRENTISS WILLSON, JR.
ROBYN H. PEKALA
MORRISON & FOERSTER
345 California Street
San Francisco, CA 94104
(415) 677-7000

CURTIS W. SCHWARTZ
MODRALL, SPERLING, ROEHL, HARRIS & SISK, P.A.
119 E. Marcy Street
Santa Fe, NM 87501

*Counsel for Petitioner*

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

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Respondent does not dispute two of the three reasons advanced by NCR in support of its petition for certiorari: first, respondent concedes that the question of factor representation, which the Court left open in *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425 (1980), has created a conflict among state courts of last resort (Op. at 15); second, respondent nowhere denies that the questions presented by the petition are of great practical significance. Instead, respondent's opposition to the petition is predicated entirely upon its view that the decision below can be squared with this Court's precedents.

Respondent contends, as it has throughout this controversy, that NCR's Foreign Commerce Clause claim is controlled by *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159 (1983). Until now, however,

respondent has relied on *Container* for the proposition that multiple international taxation is constitutionally tolerable so long as it is not inevitable. From this premise, respondent has asserted, and the court below agreed, that respondent should prevail because, "in the instant case, . . . multiple taxation, although real, is not inevitable." Pet. App. A at 11a. While concurring with respondent's premise, NCR has steadfastly contended that New Mexico's taxing scheme does in fact subject it to inevitable multiple taxation. Accordingly, up to this juncture, the heart of the Foreign Commerce Clause controversy between NCR and respondent has been whether the multiple taxation at issue here was " 'inevitabl[e].' " *Container*, 463 U.S. at 188 (quoting *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 447 (1979)).

In its brief in opposition, however, respondent's reading of *Container* has taken a dramatic turn. Respondent no longer contests the key issue that had long divided the parties—whether this case involves "inevitable" multiple taxation. *See infra* p. 3 (quoting Opp. at 10). Rather, respondent now contends that *Container* sanctions the very inevitable multiple taxation of which NCR complains, namely, multiple taxation that occurs when "foreign countries ha[ve] already taxed . . . on an unapportioned basis" the "same income" that is included "in the taxable income base apportioned by the states." Opp. at 8. As we demonstrate below, however, respondent's reading of *Container* twists it beyond recognition and does not confront the essential question of inevitable multiple international taxation that NCR has asked this Court to review.

Respondent likewise ignores the crux of NCR's argument regarding factor representation. It does not even advert to the analysis set forth in Justice Stevens' dissent in *Mobil*, which addressed the factor representation issue the Court left open and which is squarely raised by this case. Instead, respondent is content to take refuge in the

defense that NCR has allegedly failed to demonstrate "gross distortion" (Opp. at 14), while neglecting the critical question whether the distortion inquiry is relevant to a theoretically defective formula like New Mexico's.

## I. RESPONDENT'S FOREIGN COMMERCE CLAUSE DEFENSE OF NEW MEXICO'S TAXING SCHEME IS PREDICATED ON A PROFOUNDLY FLAWED READING OF *CONTAINER*

NCR's Foreign Commerce Clause argument is based on a simple syllogism: the Foreign Commerce Clause prevents a state from imposing a tax which inevitably causes international multiple taxation; New Mexico's taxing scheme inevitably causes international multiple taxation; New Mexico's taxing scheme therefore violates the Foreign Commerce Clause. Pet. at 10-15.

Respondent's brief in opposition takes no issue with the minor premise of this syllogism. Indeed, respondent explicitly recognizes that "[e]ach foreign nation's allocation to itself of all of NCR's income earned in that nation for purposes of income taxation will *always and necessarily* overlap with every state's apportioned income tax system . . . ." Opp. at 10 (emphasis supplied). Instead, respondent challenges the major premise of NCR's argument, contending that *Container* sanctions such multiple taxation and that *Container* is "indistinguishable" from this case "[i]n all relevant respects." *Id.* at 9. Specifically, respondent observes that both cases involve (1) an income tax, (2) double taxation caused by the "interplay of two different taxation methods," and (3) a domestic (rather than a foreign) taxpayer. *Id.* at 9-10.

Of these three similarities, only the second has any relevance to the Foreign Commerce Clause issue raised by NCR.[1] Moreover, with regard to the question of

[1] The two other similarities respondent has identified between this case and *Container*—that the tax is on income and that it

double taxation, respondent has failed to address, or even acknowledge, the most important distinction between this case and *Container*—a distinction with controlling constitutional significance. Unlike the double taxation in this case, the double taxation in *Container* was *not* the inevitable result of California's taxing scheme.

In *Container*, California sought to determine the state's taxable share of the income of a United States parent corporation—Container—that was engaged in a worldwide unitary business with its foreign subsidiaries. California determined its share of such income by combining Container's income with the income of its foreign subsidiaries and then apportioning a share of the combined income to California by a formula that included the

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falls on a domestic corporation—are beside the point. Earlier this year, the Court recognized in *Itel Containers Int'l Corp. v. Huddleston*, 113 S. Ct. 1095 (1993), that there were only "two distinguishing characteristics" (*id.* at 1103) between *Japan Line* and *Container* with constitutional significance: the inevitability of double taxation and the filing of an *amicus curiae* brief by the Executive Branch. Both of these elements were present in *Japan Line* but not in *Container*. *Id.* at 1103-04. We address the double taxation question in the text below. The filing of an *amicus* brief is relevant only to the question whether the tax impairs federal uniformity or prevents the Federal Government from "speak[ing] with one voice" (*Japan Line*, 441 U.S. at 449-50), an issue that NCR does not raise.

Wholly apart from *Itel*, the fact that *Container* involved a domestic corporation affected only the Court's deliberations regarding the "one voice" issue and has no bearing at all on the issue of international multiple taxation. Furthermore, the distinction the Court drew in *Container* between an income tax and a property tax is not a line between permissible and impermissible international multiple taxation. In *Container* itself, the Court recognized that "[i]f California's method of formula apportionment 'inevitably' led to double taxation . . . that might be reason enough to render it suspect." *Container*, 463 U.S. at 192-93. Moreover, the Court has observed that, in the context of income taxation, "[t]axation by apportionment and taxation by allocation to a single situs are theoretically incommensurate." *Mobil*, 445 U.S. at 444.

property, payroll, and sales factors of the entire combined group. By contrast, the foreign countries in which the foreign subsidiaries were located employed an "arm's-length" approach to determining the subsidiaries' taxable income. Under this approach, each corporation is subject to taxation "only by the jurisdictions in which it operates and only for the income it realizes on its own books." *Container*, 463 U.S. at 184.

The Court in *Container* concluded that "the double taxation in this case, although real, is not the 'inevitabl[e]' result of the California taxing scheme." *Container*, 463 U.S. at 188. The Court carefully explained the distinction between taxing schemes which may at times permissibly cause "real" multiple taxation and those which will in all cases impermissibly cause "inevitable" multiple taxation:

> In *Japan Line*, we relied strongly on the fact that one taxing jurisdiction claimed the right to tax a given value in full, and another taxing jurisdiction claimed the right to tax the same entity in part—a combination resulting necessarily in double taxation. . . . Here, by contrast, we are faced with two distinct methods of allocating the income of a multinational enterprise. The "arm's-length" approach divides the pie on the basis of formal accounting principles. The formula apportionment method divides the same pie on the basis of a mathematical generalization. Whether the combination of the two methods results in the same income being taxed twice or in some portion of income not being taxed at all is dependent solely on the facts of the individual case.

*Id.*

In short, the Court in *Container* did not sanction inevitable international multiple taxation. Instead it drew a sharp constitutional distinction between taxing schemes that necessarily produce international multiple taxation and those that adventitiously may give rise to such taxation. This crucial distinction has been entirely lost on

respondent, which has simply blurred the line between multiple taxes which are "real" and those which are "inevitable." [2] And respondent has therefore failed to recognize the constitutional significance of the distinction between the tax at issue here, which, it is now admitted (*see supra* p. 3), subjects NCR to inevitable multiple taxation, and the tax at issue in *Container*, which could as easily have led to undertaxation as to overtaxation. See *Container*, 463 U.S. at 188; Pet. at 13 n.7.[3]

For all of the reasons advanced by NCR here and in its petition for certiorari, the Foreign Commerce Clause issue warrants this Court's plenary consideration. Moreover, the Court's recent grants of certiorari in *Barclays Bank PLC v. Franchise Tax Board* (No. 92-1384) and *Colgate-Palmolive Co. v. Franchise Tax Board* (No. 92-1839) offer yet another reason for granting certiorari in this case. The Court's decision to consider these cases suggests that it is prepared to revisit at least one aspect of *Container*, namely, the "one voice" inquiry under the Foreign Commerce Clause. This case presents the other prong of Foreign Commerce Clause analysis—international multiple taxation. It will serve the interests of legal certainty and judicial economy for the Court to grant review here and, through this case, *Barclays*, and *Colgate*, to clarify *Container* and its relationship to the Court's Foreign Commerce Clause doctrine first articulated in *Japan Line*.[4]

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[2] "Blurred" may not be wholly accurate, since respondent never once even used the word "inevitable" in its brief in opposition.

[3] Multiple taxation is not inevitable when various jurisdictions divide the pie in different ways. It is clearly inevitable when, as here, one jurisdiction does not divide the pie at all.

[4] Respondent's assertion that the Court's decision in *Kraft General Foods, Inc. v. Iowa Dep't of Revenue and Finance*, 1112 S. Ct. 2365 (1992), "explicitly approved taxation of foreign source income for corporations like NCR who file as a federal consolidated taxpayer" (Opp. at 11) should not go unanswered. As respondent

## II. RESPONDENT HAS OFFERED NO PRINCIPLED RESPONSE TO NCR'S CLAIM THAT THE FACTORS OF ITS UNITARY SUBSIDIARIES MUST BE REPRESENTED IN NCR'S APPORTIONMENT FORMULA

NCR contended in its petition that this case raises a question of great practical importance, which this Court left open in *Mobil* and which has subsequently divided state courts of last resort, namely, whether a state may include in a corporation's apportionable tax base income received from its unitary subsidiaries without taking account of the subsidiaries' income-producing factors in the apportionment formula.

In its brief in opposition, respondent grudgingly acknowledges the existence of the conflict (Opp. at 15),[5]

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itself concedes (Opp. at 11-12), *Kraft* involved only the issue of discrimination against foreign commerce, a question not raised in this case. Moreover, the only point contained in the footnote cited by respondent relates to the proper standard of comparison for determining whether such discrimination exists. *Kraft*, 112 S. Ct. at 2371 n.23. In any event, the footnote contains no reference to "corporations like NCR who file as a federal consolidated taxpayer." Opp. at 11.

[5] Of the three state court decisions that conflict with the decision of the court below, respondent explicitly acknowledges the conflict with *Tambrands, Inc. v. State Tax Assessor*, 595 A.2d 1039 (Me. 1991). Opp. at 15. It asserts, however, that the other two cases NCR cited as creating a conflict with the decision below, *American Tel. & Tel. Co. v. Wisconsin Dep't of Revenue*, 143 Wis. 2d 533, 422 N.W.2d 629 (Ct. App. 1988), and *Homart Dev. Co. v. Norberg*, 529 A.2d 115 (R.I. 1987), were based "on the fact that the specific taxing schemes . . . yielded tax liabilities which were out of all appropriate proportion to the companies' business contacts with the taxing states." Opp. at 15. The suggestion that these two cases permitted factor representation because of a factual showing of distortion rather than as a matter of constitutional principle is false. The Wisconsin court in *AT&T* required a modification of the apportionment formula because "the apportionment formula used does not reflect a reasonable sense of how A.T. & T.'s income is generated" (*AT&T*, 143 Wis. 2d at 551, 422 N.W.2d at 636), not

but avoids the merits of the question that has given rise to it. Instead, respondent defends the decision below largely on the ground that New Mexico's apportionment of NCR's income, however defective from a theoretical standpoint, has not produced a "gross distortion." Opp. at 14. We have already noted that this good-enough-for-government-work defense is of questionable constitutionality in the context of an apportionment formula like New Mexico's which is flawed as a matter of principle. *See* Pet. at 19.[6] The other points that respondent raises in defense of its apportionment of NCR's income can be disposed of in short order.

Respondent claims that "New Mexico already provides NCR with factor representation" (Opp. at 12) by including the intangible income that NCR receives from its subsidiaries in NCR's sales factor. This defense fails because merely including the intangible income that NCR receives from its unitary foreign subsidiaries in NCR's sales factor—rather than including the factors of the subsidiaries themselves in NCR's factors—does not reflect how the income is generated. As the Court observed in *Container*, "the factor or factors used in the apportionment formula must actually reflect a reasonabe sense of how income is generated." *Container*, 463 U.S. at 169.

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because the application of the formula to the taxpayer produced a grossly distorted result. *See* Pet. at 16-17. Similarly, the Rhode Island court in *Homart* required a modification of the apportionment formula because "inclusion of this income in Homart's net income calculation *necessarily* requires that the payroll, property, and receipt factors that gave rise to it be included in the apportionment equation also." *Homart*, 529 A.2d at 121 (emphasis supplied).

[6] Even if the amount of distortion created by the lack of factor representation were relevant, it is greatly understated by respondent, because respondent determines NCR's factor representation by reference to the percentage of the subsidiaries' *gross* revenue paid to NCR. Opp. at 14 n.13; Pet. App. B at 59a. Since the factors are being employed to apportion *net* income, factor representation should likewise be determined by reference to the percentage of the subsidiaries' net income paid to NCR, which would substantially increase the factor representation to which NCR is entitled.

Respondent further contends that NCR's claim for factor representation should be rejected because "NCR's request to include in its apportionment factors 100% of the property, payroll and sales of these foreign subsidiaries is totally unjustified." Opp. at 13. In fact, NCR has never insisted that it was entitled, as a matter of constitutional law, to include 100 percent of the factors of its subsidiaries in its apportionment formula. NCR's position is and has always been simply that, if its "foreign source income is taxable by New Mexico and therefore apportionable, then . . . the United States Constitution [is] violated if the factors which gave rise to the income are not included in the apportionment factors." Stip. ¶ 26 (Pet. App. B at 28a).[7]

Finally, respondent asserts that NCR's claim that it is entitled to factor representation "cannot logically be limited to foreign subsidiaries or foreign sources" and "would require factor adjustment whenever business income is received from sources outside the consolidated group." Opp. at 12 n.12. The assertion is without merit. NCR's claim for factor representation is predicated on the fact that NCR and its foreign subsidiaries operate "a single, integrated, unitary business." Stip. ¶ 8 (Pet. App. B at 22a-23a). The stipulated facts thus present the quintessential case for factor representation. Whether factor representation is appropriate in other circumstances is a matter that the Court can leave for another day.

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[7] Insofar as portions of the stipulation included all of the subsidiaries' factors in NCR's apportionment formula, this merely reflected an agreement of the parties as to the disposition of the case should NCR or the respondent prevail. It did not reflect the parties' position on the factor representation that was required as a matter of federal constitutional law.

## CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

JAMES P. KRATOCHVILL
AMERICAN TELEPHONE & TELEGRAPH COMPANY
295 North Maple Avenue
Basking Ridge, NJ 07920

WILLIAM R. CARAPEZZI, JR.
NCR CORPORATION
1700 South Patterson Blvd.
Dayton, OH 45479

WALTER HELLERSTEIN
*Counsel of Record*
PAUL H. FRANKEL
PRENTISS WILLSON, JR.
ROBYN H. PEKALA
MORRISON & FOERSTER
345 California Street
San Francisco, CA 94104
(415) 677-7000

CURTIS W. SCHWARTZ
MODRALL, SPERLING, ROEHL, HARRIS & SISK, P.A.
119 E. Marcy Street
Santa Fe, NM 87501

*Counsel for Petitioner*